Chapter 6

Request for Comments

6.1 Request for Comments

6.1.1 Proposed OSC Rule 45-501 Exempt Distributions

NOTICE OF PROPOSED RULE, POLICY AND FORMS
UNDER THE SECURITIES ACT
RULE 45-501 EXEMPT DISTRIBUTIONS
COMPANION POLICY 45-501CP
FORM 45-501F1, FORM 45-501F2, FORM 45-501F3
AND
RESCISSION OF EXISTING RULE 45-501 AND
COMPANION POLICY 45-501CP AND
RULE 45-504 PROSPECTUS EXEMPTION FOR
DISTRIBUTIONS OF SECURITIES
TO PORTFOLIO ADVISERS ON BEHALF OF FULLY
MANAGED ACCOUNTS

Introduction

On April 6, 2001, the Commission republished proposed Rule 45-501 *Exempt Distributions*, together with three proposed Forms and a proposed Companion Policy, at (2001) 24 O.S.C.B. 2187 (the "April Materials"). As a result of staff's recommendations, comments received and further deliberations of the Commission, the Commission has amended the proposed Rule, Forms and Companion Policy and is republishing them for a 30 day comment period.

Proposed Rule 45-501 *Exempt Distributions* (the "Proposed Rule") is intended to replace existing Rule 45-501 *Exempt Distributions* and to implement the suggestions of the Task Force on Small Business Financing (the "Task Force") as set out in the October 1996 Report of the Task Force as it was presented to the Commission (the "Report"). On May 7, 1999, the Commission published a concept paper entitled "Revamping the Regulation of the Exempt Market" ((1999) 22 O.S.C.B. 2835) (the "Concept Paper") which was based on the recommendations contained in the Report and outlined the Commission's proposals.

On September 8, 2000, the Commission published for comment a draft of the Proposed Rule, three forms and a companion policy (the "September Materials"). The Commission received submissions on the September Materials from 26 commentators. For a summary of these comments and the Commission's response, please see (2001) 24 O.S.C.B. 2196.

The Commission received submissions on the April Materials from 17 commentators. The Commission has revised the Proposed Rule further based on the latest set of comments received. For a summary of these comments and the Commission's response, please see Appendix A to this Notice.

The Proposed Rule will also replace Rule 45-504 *Prospectus Exemption for Distributions of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts* which is being repealed upon the coming into force of the Proposed Rule, as its provisions will be incorporated in the Proposed Rule.

Substance and Purpose of the Proposed Rule and the Forms

The purpose of revising the existing Rule and Forms is to create an approach to private market regulation that is consistent with the needs of that market and its investors.

The Commission hopes that the new exempt market regime contemplated under the Proposed Rule will be viewed as an improvement over the existing exempt market regulations. The existing Rule was introduced as an interim consolidation of the exempt distribution provisions that had previously not been consolidated. The Proposed Rule is intended to implement the recommendations of the Task Force as set out in the Report and the views of the staff of the Commission on those recommendations as well as consideration of the views of the many commentators who expressed views on the Concept Paper, the September Materials and the April Materials.

This Notice summarizes changes of a substantive nature that have been made since the publication of the April Materials. For additional information concerning the background to the Proposed Rule, reference should be made to the September Materials. Also, a detailed summary of the Proposed Rule may be found in the Notice published with the September Materials at (2000) 23 O.S.C.B. 6205.

Substance and Purpose of Proposed Companion Policy

The purpose of the Proposed Policy is to set forth the views of the Commission as to the manner in which the Proposed Rule and the provisions of the Act relating to exempt distributions are to be interpreted and applied.

Summary of Changes to the Proposed Rule

The following summary indicates the substantive changes to the Proposed Rule from the version published in the April Materials.

Pooled Funds

Based on the comments received on the April Materials, section 2.12 has been added to the Proposed Rule to create an exemption for private pooled funds which have historically relied on the $150,000 exemption and rulings allowing for "top-up" sales to existing investors. This exemption, coupled with

OSC Rule 81-501 *Mutual Fund Reinvestment Plans*[1], will maintain the status quo. This exemption has been added to address the concerns of many pooled fund managers outlined in the comment letters received and to avoid the need for a significant number of exemptive relief applications from private pooled funds. This exemption will be available until staff determines the best approach to pooled fund management. The resale of a security acquired under the exemption from the prospectus requirement in section 2.12 of the Proposed Rule will be subject to section 2.5 of Multilateral Instrument 45-102.

A request for comments will be published shortly requesting comments from stakeholders on the nature and use of pooled funds and if these pooled funds should be subject to a unique regulatory regime.

Government Incentive Security

Based on the comments received on the April Materials, the government incentive security exemption, as it relates to flow-through share offerings, has been included in the Proposed Rule as section 2.13 and a related resale exemption has been included as section 2.14. Staff received significant representations that the continued existence of the government incentive security exemption was integral to the success of the "super" flow-through share program instituted by the federal government. Section 4.1 has been revised to extend the statutory right of action referred to in section 130.1 of the Act to apply in respect of an offering memorandum delivered to a prospective purchaser in connection with a trade made in reliance upon the government incentive security exemption. Consistent with the previous treatment of resales of securities acquired under this exemption, resales will be subject to section 2.5 of Multilateral Instrument 45-102.

Other

Director and officers have been removed from paragraph (p) of the definition of "accredited investor" as these individuals are covered under Rule 45-503 *Trades to Employees, Executives and Consultants*.

The definition of "closely-held issuer" has been clarified to exclude debt securities held by a Canadian financial institution from the securities transfer restrictions and the limitation on the number of holders.

The definition of "financial assets" has been revised to also include any contract of insurance that is not a security for the purposes of the Act.

Section 2.1, the exemption for the trade of a security of a closely-held issuer, has been revised in order to allow for expenses to be paid for services performed by a dealer registered under the Act.

Subsection 3.4(2) has been revised to allow a limited market dealer to act as a market intermediary in respect of a trade under any exemption from the registration required referred to in subsection 3.4(1).

Summary of Changes to the Proposed Policy

The Policy sets forth the views of the Commission as to the manner in which certain provisions of the Act and the rules relating to exempt distributions are to be interpreted and applied.

Subsection 2.1 of the Policy was clarified to indicate the Commission's views on the interaction of the private placement exemptions. Subsection 2.2(3) of the Policy was added in order to note that Rule 45-503 *Trades to Employees, Executives and Consultants* will result in officers and directors of an issuer or its affiliated entities being treated as accredited investors. Section 2.8 has been added to the Policy which discusses the Commission's views on applications for recognition as an accredited investor.

Other changes to the Policy made since the September Materials were made to reflect the changes to the Proposed Rule discussed above and are not otherwise material.

Authority for the Proposed Rule and Forms

The following sections of the Act provide the Commission with authority to adopt the Proposed Rule and Forms. Paragraphs 143(1)8 and 20 authorize the Commission to make rules which provide for exemptions from the registration and prospectus requirements under the Act and for the removal of exemptions from those requirements. Paragraph 143(1)11 authorizes the Commission to make rules regulating the listing or trading of publicly traded securities and paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that is fraudulent, manipulative, deceptive or unfairly detrimental to investors. Paragraph 143(1)39 authorizes the Commission to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by this Act, the regulations or the rules and all documents determined by the regulations or the rules to be ancillary to the documents and paragraph 143(1)43 authorizes the Commission to make rules prescribing fees.

Related Instruments

The Proposed Rule and Companion Policy are related in that they deal with the same subject matter. The Proposed Companion Policy is related to Parts XII and XVII of the Act and Parts III and V of the Regulation.

Conflicting Regulations

In connection with the implementation of the Proposed Rule, it is the intention of the Commission to amend the Regulation under the Act to the extent that certain provisions of the Regulation require consequential amendment. The implementation of the Proposed Rule requires that the following amendments to the Regulation be made:

1. Subsections 149(1), (2) and (3), which deal with applications for exempt purchaser recognition, will be revoked since the exemptions for persons or

[1] OSC Rule 81-501 operates to permit private pooled funds to issue securities to investors under reinvestment plans, being plans to reinvest distributions or dividends of income, capital or capital gains.

companies that are exempt purchasers will no longer be available.

2. Clause 154(1)(c) refers to the exemptions from the prospectus requirement under clauses 72(1)(a), (c) and (d) of the Act, all of which will no longer be available. Clause 154(1)(c) will be amended to delete the references to these exemptions and to refer to the exemption for accredited investors as set out in the Proposed Rule.

3. The definition of "designated institution" in subsection 204(1) of the Regulation will be amended to delete clause (i), which refers to an exempt purchaser, and to add a new clause (i) as follows:

   (i) a company or a person, other than an individual, that is an accredited investor as defined in section 1.1 of Ontario Securities Commission Rule 45-501 *Exempt Distributions,*

4. Subsection 45(1) of Schedule 1 - Fees will be revoked since applications for exempt purchaser recognition will no longer be accepted. Section 7.6 of the Proposed Rule prescribes the amount of fees payable in respect an application for accredited investor recognition.

5. Form 11, Application For Recognition As An Exempt Purchaser will be revoked since the related exemptions from the registration and prospectus requirements will no longer be available.

Comments

Interested parties are invited to make written submissions with respect to the Proposed Rule. Submissions received by Monday, August 13, 2001 will be considered. **Please note that due to timing concerns, comments received after the deadline will not be considered.**

Submissions should be made to:

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8
email: **jstevenson@osc.gov.on.ca**

A diskette containing an electronic copy of the submissions (in DOS or Windows format, preferably WordPerfect) should also be submitted. As the Act requires that a summary of written comments received during the comment period be published, confidentiality of submissions received cannot be maintained.

Questions may be referred to:

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Text of Proposed Rule

The text of the Proposed Rule, the Companion Policy and the Forms follows, together with footnotes that are not part of the Proposed Rule, Companion Policy or Forms but have been included for purposes of explanation.

Rescission of Existing Rule

The Proposed Rule will result in the rescission of existing Rule 45-501 *Exempt Distributions* and Rule 45-504 *Prospectus Exemption for the Distribution of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts*. The text of the proposed rescission will be as follows:

> "Rule 45-501 *Exempt Distributions* is hereby rescinded."
>
> "Rule 45-504 *Prospectus Exemption for Distribution of Securities to Portfolio Advisers on Behalf of Fully Managed Accounts* is hereby rescinded."

July 13, 2001.

APPENDIX A

SUMMARY OF COMMENTS RECEIVED BY THE COMMISSION ON PROPOSED RULE 45-501 - *EXEMPT DISTRIBUTIONS*

This is a summary of the comments received by the Commission during the 30 day comment period from April 6, 2001 to May 7, 2001. References to the "September comment period" in this summary means the 90 day comment period from September 8, 2000 to December 8, 2000.

The Commission received submissions from 17 commentators and would like to take this opportunity to thank each of the commentators for taking the time to express their views on this initiative.

GENERAL COMMENTS

Commentators would like to see the new regime harmonized across the country and recommended that the Commission work with members of the Canadian Securities Administrators to do so as quickly as possible. It was noted that the administrative costs of multiple regulatory regimes undermines the improvements to Ontario's capital markets resulting from the proposed Rule.

A similar comment was received during the September comment period. The Commission at that time advised that it recognizes the benefits that could be derived from a nationally harmonized exempt market regime and the Commission will continue to pursue the possibility of developing such a regime. However, the Commission is of the view that the goal of harmonization should not be permitted to adversely affect the timely implementation of the improvements to the Ontario capital markets contemplated by the proposed Rule.

One commentator was concerned that the proposed Rule would restrict involvement in public company financing to the very wealthy and suggested adopting an exempt market regime similar to that in British Columbia to address this. Another commentator suggested that the proposed Rule does not provide an adequate balance between efficiency for small cap companies in raising capital, opportunity for more Canadians to invest in small cap companies and protection for investors from taking undue risk.

The Commission recognizes that there are many potential types and combinations of exemptions that could be used to produce an exempt market regulatory regime. The Task Force canvassed the various possibilities including the regimes in British Columbia and the United States and determined that the proposed regime is most appropriate for the Ontario capital markets. The Commission agrees with the Task Force's recommendations and is of the view that the proposed regime will better facilitate capital formation in Ontario and ensure adequate investor protection.

SPECIFIC COMMENTS - THE RULE

Section 1.1 - Definitions

"Accredited Investor"

Paragraph (a)

A commentator noted that the reference in this paragraph ought to be to "an authorized foreign bank", as is listed in Schedule III in the *Bank Act*, rather than "an authorized foreign bank branch".

This paragraph has been amended to address this point.

Paragraphs (a), (b) and (c)

One commentator was concerned that granting accredited investor status to banks and trust companies unfairly grants preferred status to the investment departments of these organizations vis a vis investment counsellors. The commentator recommended amending the proposed Rule to not include these organizations in the definition.

The entities referred to in these paragraphs are the same entities currently referred to in subsection 72(1)(a) of the Act. Theses entities are not preferred vis a vis investment counsellors because they must purchase as principal in order to rely on the accredited investor exemption in section 2.3 of the proposed Rule.

Paragraph (k)

It was suggested by one commentator that Group RRSPs ought to be included within the definition, as it is strongly arguable that the fiduciary duties and trust obligations are similar in this context to those for pension plans and often employers consult with professional advisors in developing investment options. If not included at this time, the commentator sought direction on when an appropriate regulatory regime would be developed for Group RRSPs.

A similar comment was received during the last comment period. The Commission at that time advised that certain of the noted entities may fall within the definition of accredited investor if they take the form of a person or entity referred to in paragraph (t) and have the requisite net asset level.

Paragraphs (m) and (n)

Commentators suggested that the qualification levels to become an accredited investor under the proposed Rule are too high and therefore exclude too many Canadian investors. One commentator noted that a wealth test is an unfair route to access the exempt market and that new financing investments present risk that is often more suitable to the vast majority of investors than to the very wealthy. Another commentator suggested a threshold of financial assets of a minimum of $200,000, with an investor limited to investing a maximum of 20% of their assets in a private placement.

The Commission received a similar comments during the previous comment periods. The Task Force and the Commission previously dismissed the idea of exemptions which permit investors to invest a percentage of net worth or

income as being too cumbersome, too complex to administer and not an adequate proxy for sophistication. It is the Commission's view that determining whether an investor exceeds an asset threshold is much simpler and more appropriate than determining an exact level of assets for the purposes of a percentage investment scheme.

One commentator was concerned that the definition of accredited investor does not include children or other dependants of persons in paragraphs 1.1(m) and (n). The commentator noted that, while paragraphs (y) and (aa) will accommodate some of these people, paragraph (y) is limited to accounts fully managed by a trust company and paragraph (aa) is limited to circumstances where all the people concerned are accredited investors. The only paragraph that accommodates investors with assets beneficially owned by minors or dependants is 1.1(t), and it requires net assets of $5,000,000, well in excess of the individual requirement of $1,000,000 in paragraph 1.1(m). The commentator sought a remedy for this situation.

The accredited investor exemption is based primarily on an individual's ability to withstand the loss of an investment. Based on this rationale the exemption is available to children who meet the prescribed thresholds in paragraph 1.1(m) and (n).

Paragraph (n)

One commentator recommended that the appropriate income level for the purpose of this section is "total income" as calculated for federal income tax purposes and not "net income". The commentator noted that if an investor's sophistication is deemed to be based on their historic income level and their ability to generate income in the future, the deductions available to a particular investor for tax purposes in a given year should not be relevant. Further, the income aspect of the accredited investor exemption should not serve as a disincentive for investors who want to participate in the exempt market from planning their affairs in a manner that minimizes tax.

The Commission received similar comment during the September comment period. The Commission at that time advised that it is of the view that an appropriate net income figure to use for the purpose of determining eligibility is net income as calculated for federal income tax purposes prior to the deduction of income tax credits. The threshold amount was set based on an analysis of the ability to withstand loss of an investment. Utilizing a total income test as suggested by the commentator above would likely result in a higher threshold amount for the purpose of this section.

Paragraph (o)

One commentator noted that certain investment professionals may not qualify as accredited investors under the proposed Rule. It was suggested that these individuals clearly have the investment knowledge to make proper investment decisions and recommended that they be included in the definition. Another commentator suggested that any investor who successfully completes the proficiency requirements to become a registered representative, whether or not they have been granted registration, should be an accredited investor. It was noted that many individuals in the securities industry complete the proficiency requirements without going on to become registered representatives. The commentator pointed out, in support of this recommendation, that the section as currently drafted does not require an individual's registration to be currently in effect.

Registrants are included as accredited investors because generally they are, or at one time have been, employed by a registered dealer or adviser. Because they have industry experience these participants are considered able to determine when to seek advice concerning a particular potential investment.

Paragraph (p)

One commentator recommended that the definition of accredited investor should be expanded to refer to officers or directors of affiliated entities of the issuer.

Trading by directors and officers of an issuer (and of an issuer's affiliates) is currently addressed in OSC Rule 45-503 - Trades to Employees, Executives and Consultants. Accordingly, references to directors and officers have been removed from this paragraph.

Paragraph (t)

One commentator noted that as this section already includes limited partnerships and limited liability partnerships it should also include general partnerships - this commentator could see no policy reason to distinguish among the three different types of partnerships.

The purpose of this section is to recognize and facilitate corporate type vehicles as accredited investors. Unlike in a limited partnership and in a limited liability partnership, in a general partnership every partner is potentially fully liable for the liabilities or losses incurred by the partnership and therefore must be able to withstand such loss. Therefore, the Commission is of the view that every partner in a general partnership should individually be an accredited investor.

Paragraph (u)

It was recommended that the proposed Rule be clarified to indicate that individuals may be recognized as accredited investors and that direction be provided regarding who may apply for such recognition, whether it must be the investor or if it could be the issuer on the investor's behalf.

This provision is intended to give the Commission flexibility to grant accredited investor status for a particular circumstance not already considered and listed in the definition of accredited investor. All general circumstances which would give rise to accredited investor status are currently included. The Commission will consider applications for recognition on a case by case basis. Applications for recognition may be filed by an agent for the applicant but the investor will be the applicant for accredited investor status.

Paragraph (z)

It was recommended that this paragraph be expanded to refer also to investors of the type referred to in paragraphs (k), (l), (x) and (y) that are regulated outside of Canada.

Because regulatory approaches outside of Canada vary from jurisdiction to jurisdiction the Commission is of the view that the appropriate approach is to consider foreign regulated investors on a case by case basis.

Paragraph (aa)

One commentator sought clarification regarding the reference in this paragraph to the term "interests". Specifically, the commentator sought assurance that this term does not include debt securities. A commentator also remarked that it is not clear how this provision could work in a multi-jurisdictional manner, and suggested that it be limited to parties in Ontario.

The term "interests" is intentionally broad and does encompass debt securities. The Commission is of the view that debt securities could be important obligations of a company in which case the creditor should be an accredited investor. The proposed Rule is not a multi-jurisdictional instrument - it applies only to distributions in Ontario.

Other

One commentator recommended including charities, small foundations and corporate savings plans within the definition of accredited investor, because these entities will otherwise be left with fewer investment options after the proposed Rule comes into place. Another commentator recommended including tax exempt institutional investors such as endowments and foundations, given their sophistication and similarities to charities and registered retirement savings plans. Another commentator was concerned about family trusts and wished to see these included within the definition of accredited investor.

The Commission received similar comment during the September comment period. The Commission at that time advised that certain of the noted entities may fall within the definition of accredited investor if they take the form of a person or entity referred to in paragraph (t) and have the requisite asset level or if they are registered charities. The Commission is of the view that because many of the entities referred to by the commentators are difficult to precisely define it is more appropriate to consider each of these entities on a case by case basis.

One commentator questioned whether a brokerage firm would be allowed to raise capital on the Internet for an issuer if a password-protected website is in place to pre-qualify accredited investors.

As discussed in section 3.1 of the Companion Policy accompanying the proposed Rule, ultimately it is the seller's responsibility to ensure that trades in securities, regardless of the medium by which such trades are effected, be made in compliance with applicable securities laws.

"Closely-Held Issuer"

One commentator suggested that the concept of the closely-held issuer is outdated and ought to be eliminated. This commentator noted that the limit of $3 million from 35 non-accredited investors is overly restrictive, that there is too great a gap between permitting any 35 investors, irrespective of financial means, to invest in a closely held issuer and permitting only investors with $1 million in assets or $200,000 in annual income to invest in any other private placement. It was recommended that this exemption be made available to all issuers, or at least be made more widely available, perhaps to public companies under a certain market value.

The Commission received a similar comment during the September comment period. The Commission at that time advised that the '35 unaccredited investor' limit provided for in the proposed closely-held issuer exemption represents a balance between: (a) facilitating small companies' access to capital; and (b) limiting the potential risk assumed by unsophisticated investors. The closely-held issuer exemption is designed to be used by companies to raise investment capital from people and entities known by the issuer's principals and not through broad solicitations of potential investors. The private issuer exemption achieved a similar objective by prohibiting offers to the public. Furthermore, the closely-held issuer exemption may prove less numerically restrictive than the private issuer exemption because accredited investors would count towards the 50 investor limit for purposes of the private issuer exemption whereas they would not count toward the 35 investor limit under the closely-held issuer exemption.

One commentator suggested that the carve out in the definition of "closely-held" issuer should not refer to a non-redeemable investment fund.

The Commission is of the view that the closely held issuer exemption is intended to facilitate small business start-up financing; it is not intended to promote investment vehicles. Moreover, non-redeemable investment funds will have the benefit of the $150,000 exemption found in section 2.12 of the proposed Rule.

Section 2.1 - Exemption for a Trade in a Security of a Closely-Held Issuer

Paragraph (1)(b)

One commentator objected to the restriction on promoters for closely-held issuers. They noted that the intention of the section appears to be to prevent promoters from abusing the 35 security-holder exemption by financing through multiple closely-held issuers, but that its effect will be to preclude a closely-held issuer with a promoter in common with another closely-held issuer from financing under this exemption within the same 12 month period as the other. This was noted to be more restrictive than the current private issuer exemption and unduly restrictive of a closely-held issuer's ability to raise capital. The commentator recommended that the paragraph be deleted or modified so as to not preclude a promoter from relying on the closely-held issuer exemption more than once every twelve months for issuers not involved in a common enterprise.

The Commission is of the view that if a promoter wishes to use this exemption for another, separate, enterprise within the same twelve month period, the promoter can apply to the Commission for relief from the application of this prohibition.

Paragraph (1)(c)

One commentator recommended that a closely-held issuer be able to engage the services of a registrant in raising capital under the closely-held issuer exemption if it so chooses. Because the regulatory risk in this exemption has been capped at 35 holders and $3 million, no risk would be added by the inclusion of a registrant under the Act. Further, due diligence work performed and advice provided by the registrant would foster investment protection and lead to more efficient capital formation. Accordingly, the commentator recommended that the following phrase be added to the end of paragraph 2.1(1)(c): ", except for services performed by a registered dealer."

Another commentator expressed concern about the effective restriction in the proposed Rule on utilizing the services of a registered dealer in connection with the closely held issuer exemption. It was suggested that this effective prohibition is a serious disadvantage and competitive impediment. It was further suggested that permitting a brokerage firm to act as an agent on a closely-held issuer financing involving accredited investors but not in the same financing involving non-accredited investors, as provided in the proposed Rule, will be impossible in practice. Another commentator noted that it will be impossible to segregate the involvement of the brokerage firm as between accredited and non-accredited investors. Further, the agent ought to be compensated for their involvement even if the offering ends up being placed with non-accredited investors. Finally, a commentator suggested that in some closely-held issuer financings, the brokerage firm is exactly the party that should be involved, to provide an independent assessment of the issuer's plans for investors who are relatives. Another commentator expressed difficulty in ascertaining the precise extent of the prohibition against brokerage firms and seeks clarification in the proposed Rule.

In response to comments and upon further consideration the proposed Rule has been revised to permit an issuer that is relying on the closely held issuer exemption to utilize the services of a dealer registered under the Act by removing the prohibition on dealer compensation in connection with this exemption. Subsection 2.1(1)(c) in the proposed Rule has been revised to include the phrase "except for services performed by a dealer registered under the Act" after the phrase "no selling or promotional expenses are paid or incurred in connection with the trade".

Section 3.1 - Removal of Certain Exemptions Generally

A number of commentators recommended retaining the $150,000 exemption rather than adopting the proposed Rule. It was noted by others to be incongruous to suggest that those previously sophisticated enough to undertake exempt investment are now no longer so. A number of commentators also expressed concerns about accessibility, noting that the proposed restrictive wealth requirements would bar most Canadian investors from participating in the exempt market. It was suggested that this was a negative feature of the proposed Rule. Other commentators recommended retaining the $150,000 exemption alongside the proposed qualifications. It was suggested that neither the income or asset test is a better proxy for sophistication than the current $150,000 exemption. It was also noted that the current exemption has worked well historically and is consistent with the approach of other Canadian jurisdictions and thus ought to be retained. It was suggested that the proposed income or asset tests have a higher potential for abuse than the $150,000 exemption.

The Commission is of the view that the asset and net worth tests are based on the Task Force's conclusion that an investor's sophistication should be measured primarily by the ability to withstand the loss of the investment. While using either a 'net worth' test or an income test to determine whether a potential investor can afford to lose an investment cannot fully assess sophistication, such tests do provide a strong proxy for sophistication. The Commission believes that the $150,000 is not an appropriate proxy for sophistication and therefore maintaining the $150,000 exemption is untenable. The Commission is of the view that the proposed Rule provides for a flexible yet simple regulatory scheme which will facilitate the raising of capital throughout the various stages of business development while providing appropriate investor protection. The Commission will monitor the efficacy of the new regime to ensure that it is meeting the needs of the marketplace and its investors.

Removal of the Government Incentive Security Exemption

One commentator was very concerned about the impact of the proposed Rule on junior exploration issuers and, consequently, the Canadian resource sector and northern communities, based on the proposal to eliminate the government incentive security exemption in section 2.4 of the current Rule 45-501. The commentator noted that the elimination of the exemption will inhibit the ability of exploration issuers to take full advantage of the new Super Flow-through Share Program recently implemented by both federal and provincial levels of government.

The proposed Rule has been amended to retain the current government incentive security exemption as it relates to the issuance of flow-through shares. The exemption is now found at section 2.13 of the proposed Rule.

Section 6.5 - Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or an Exchangeable Security Acquired Under Certain Exemptions

One commentator noted that while this section will serve to close the control block gap in section 6.4 of the existing Rule 45-501 by replacing the word "issue" with "acquired", that the proposed drafting would apply resale restrictions to securities transferred on exchange of an exchangeable security even if the exchange is not a distribution. This would result in resale restrictions becoming applicable to securities that were previously freely tradeable.

This paragraph has been amended by including, after the word "acquired", the phrase "under an exemption from the prospectus requirement". Accordingly, only underlying securities that are transferred in a trade which constitutes an exempt distribution will be subject to resale restrictions.

Section 6.7 - Resale of a Security Acquired under Section 2.5 or 2.8

One commentator suggested that the concluding phrase in section 6.7 of the proposed Rule "unless...the trade is exempt under section 2.9 of MI 45-102" raised doubt about the applicability of the exemption under section 2.12 of proposed MI 45-102 in relation to section 6.4 of the proposed Rule because section 6.4 does not specifically refer to available exemptions.

The proposed Rule has been revised by removing the trailing language in section 6.7, "unless...the trade is exempt under section 2.9 of MI 45-102."

Section 6.8 - Resale of a Security Acquired Under Certain Exemptions in Rule 45-503

One commentator interpreted this section as requiring the filing of a certificate after the issuance of all shares issued upon the exercise of options and noted that for an active employee stock option plan, this would be an onerous task without providing any useful information. In the context of employee stock option plans, it ought to be sufficient to file annually. Thus, an amendment was requested to provide that qualified issuers would be required to file this certificate annually for the purposes of Rule 45-503.

This comment will be addressed in Rule 45-503 and/or in proposed MI 45-102 - Resale of Securities.

Section 7.5 - Exempt Trade Reports

Paragraph (1)

A commentator recommended that the carve out in section 7.5(1), as to trades where no report is required, should be expanded so that no report or fee is required for trades with accredited investors pursuant to paragraph (aa) of the definition where the applicable investors owning the entity in paragraph (aa) are those referred to in paragraphs (p) through (s).

The proposed Rule has been revised to reflect this comment.

Comments Relating to Pooled Funds

A significant amount of comment was received from investment counsel/portfolio manager registrants ("ICPMs") concerning the treatment of managed accounts and pooled funds in the proposed Rule; following the coming into force of the proposed Rule, managed accounts would be prohibited from purchasing units of pooled funds unless the principal of the managed account qualified as an accredited investor. The proposed Rule provides that managed accounts purchasing securities *other than securities of a mutual fund or non-redeemable investment fund* qualified as an accredited investor. Commentators were almost universally of the view that managed accounts should be permitted to acquire units of pooled funds irrespective of whether the principal of the account is an accredited investor.

Staff also received numerous comments, generally from the ICPM community, relating to specific issues that the ICPM community would like to see addressed pertaining to the regulation of pooled funds. As articulated in the notices accompanying the previous publications of the proposed Rule, the Commission is the view that the use of in-house pooled funds by ICPMs may raise some unique regulatory concerns that need to be examined prior to any expansion of their permitted use. Accordingly, the investment funds regulatory reform team has commenced a project to examine pooled funds and, if necessary, to develop an appropriate regulatory regime. Commentators generally welcomed this review, but urged the Commission to provide for a suitable transition period in the proposed Rule for the interim period.

The proposed Rule has been revised by including section 2.12 the effect of which is to maintain the current regulatory regime, as it applies to pooled funds, until this project is complete and until the issues and comments raised during the most recent comment period are fully considered by the Commission.

The Companion Policy

It was suggested that the companion policy should be clarified to confirm whether the assets in a client's RRIFs are to be included in the calculation of that client's financial assets.

The reference to RRSPs in section 2.2 of the Companion Policy is an example that has been included for the purpose of illustrating the factors that the Commission is of the view are indicative of beneficial ownership of financial assets. The Commission does not propose to include a discussion of RRIFs.

Section 4.1 - Use of Offering Memoranda in Connection with Private Placements

Paragraph (2)

This paragraph refers to prescribed contents of an offering memorandum as set out in proposed National Instrument 52-101 *Future-Oriented Financial Information*. A commentator pointed out that the Commission currently has no prescribed requirement relating to the use of forecasts in offering memoranda because National Policy 48 was not made into a Rule, and this ought to be made clear in the Companion Policy. It was suggested that this could always be amended in a new Instrument, but that the proposed Companion Policy is confusing because of the implication of a current prescribed requirement regarding forecasts in offering memoranda. Another requirement, besides the contractual right and the future-oriented financial information, is certain disclosure of a relationship between related and connected issuers. The commentator suggested that this also ought to be reflected in the Companion Policy.

The Companion Policy has been clarified to address this point.

SCHEDULE A - LIST OF COMMENTATORS

1. Barclays Global Investors
2. Canaccord Capital
3. High Street Asset Management Inc.
4. I.A. Michael Investment Counsel Ltd.
5. Investment Counsel Association of Canada
6. Investment Funds Institute of Canada
7. Judy Socha
8. Stikeman Elliott
9. Kutkevicius Kirsh LLP
10. Northern Securities Inc.
11. Osler, Hoskin & Harcourt LLP
12. Borden Ladner Gervais
13. Prospectors and Developers Association of Canada
14. R.A. Floyd Capital Management Inc.
15. RBC Investments
16. TD Bank Financial Group
17. Torys

ONTARIO SECURITIES COMMISSION RULE 45-501

EXEMPT DISTRIBUTIONS

PART 1 DEFINITIONS

1.1 Definitions - In this Rule

"accredited investor" means

(a) a bank listed in Schedule I or II of the *Bank Act* (Canada), or an authorized foreign bank listed in Schedule III of that Act;

(b) the Business Development Bank incorporated under the *Business Development Bank Act* (Canada);

(c) a loan corporation or trust corporation registered under the *Loan and Trust Corporations Act* or under the *Trust and Loan Companies Act* (Canada), or under comparable legislation in any other jurisdiction;

(d) a co-operative credit society, credit union central, federation of caisses populaires, credit union or league, or regional caisse populaire, or an association under the *Cooperative Credit Associations Act* (Canada), in each case, located in Canada;

(e) a company licensed to do business as an insurance company in any jurisdiction;

(f) a subsidiary of any company referred to in paragraph (a), (b), (c), (d) or (e), where the company owns all of the voting shares of the subsidiary;

(g) a person or company registered under the Act or securities legislation in another jurisdiction as an adviser or dealer, other than a limited market dealer;

(h) the government of Canada or of any jurisdiction, or any crown corporation, instrumentality or agency of a Canadian federal, provincial or territorial government;

(i) any Canadian municipality or any Canadian provincial or territorial capital city;

(j) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any instrumentality or agency thereof;

(k) a pension fund that is regulated by either the Office of the Superintendent of Financial Institutions (Canada) or a provincial pension commission or similar regulatory authority;

(l) a registered charity under the *Income Tax Act* (Canada);

(m) an individual who beneficially owns, or who, alone or together with a spouse, beneficially owns, financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $1,000,000;

(n) an individual whose net income before taxes exceeded $200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded $300,000 in each of those years and who, in either case, has a reasonable expectation of exceeding the same net income level in the current year;

(o) an individual who has been granted registration under the Act or securities legislation in another jurisdiction as a representative of a person or company referred to in paragraph (g), whether or not the individual's registration is still in effect;

(p) a promoter of the issuer or an affiliated entity of a promoter of the issuer;

(q) a spouse, parent, grandparent or child of an officer, director or promoter of the issuer;

(r) a person or company that, in relation to the issuer, is an affiliated entity or a person or company referred to in clause (c) of the definition of distribution in subsection 1(1) of the Act;

(s) an issuer that is acquiring securities of its own issue;

(t) a company, limited partnership, limited liability partnership, trust or estate, other than a mutual fund or non-redeemable investment fund, that had net assets of at least $5,000,000 as reflected in its most recently prepared financial statements;

(u) a person or company that is recognized by the Commission as an accredited investor;

(v) a mutual fund or non-redeemable investment fund that, in Ontario, distributes its securities only to persons or companies that are accredited investors;

(w) a mutual fund or non-redeemable investment fund that, in Ontario, distributes its securities under a prospectus for which a receipt has been granted by the Director;

(x) a managed account if it is acquiring a security that is not a security of a mutual fund or non-redeemable investment fund;

(y) an account that is fully managed by a trust corporation registered under the *Loan and Trust Corporations Act*;

(z) an entity organized outside of Canada that is analogous to any of the entities referred to in paragraphs (a) through (g) in form and function; and

(aa) a person or company in respect of which all of the owners of interests, direct or indirect, legal or beneficial, are persons or companies that are accredited investors;

"closely-held issuer" means an issuer, other than a mutual fund or non-redeemable investment fund, whose outstanding securities

(a) are, except for debt securities[1] held by a Canadian financial institution[2], subject to restrictions on transfer contained in constating documents of the issuer or one or more agreements among the issuer and holders of its securities; and

(b) are beneficially owned, directly or indirectly, by not more than 35 persons or companies, exclusive of

(i) persons or companies that are, or at the time they last acquired securities of the issuer were, accredited investors; and

(ii) current or former employees of the issuer or an affiliated entity of the issuer, or current or former consultants as defined in Rule 45-503 *Trades to Employees, Executives and Consultants*, who in either case beneficially own only securities of the issuer that were issued as compensation by, or under an incentive plan of, the issuer or an affiliated entity of the issuer;

provided that:

(A) two or more persons who are the joint registered holders of one or more securities of the issuer shall be counted as one beneficial owner of those securities; and

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1 "Debt security", for the purposes of this Rule, has the same definition as set out in subsection 1(2) of the Regulation, meaning "any bond, debenture, note or similar instrument representing indebtedness, whether secured or unsecured".

2 "Canadian financial institution", for purposes of this Rule, is defined in subsection 1.1(3) of National Instrument 14-101 *Definitions* as "a bank, loan corporation, trust company, insurance company, treasury branch, credit union or caisse populaire that, in each case, is authorized to carry on business in Canada or a jurisdiction, or the Confédération des caisses populaires et d'économie Desjardins du Québec".

(B) a corporation, partnership, trust or other entity shall be counted as one beneficial owner of securities of the issuer unless the entity has been created or is being used primarily for the purpose of acquiring or holding securities of the issuer, in which event each beneficial owner of an equity interest in the entity or beneficiary of the entity, as the case may be, shall be counted as a separate beneficial owner of those securities of the issuer;

"convertible security" means a security of an issuer that is convertible into, or carries the right of the holder to purchase, or of the issuer to cause the purchase of, a security of the same issuer;

"entity" means a company, syndicate, partnership, trust or unincorporated organization;

"exchangeable security" means a security of an issuer that is exchangeable for, or carries the right of the holder to purchase, or of the exchange issuer to cause the purchase of, a security of another issuer;

"exchange issuer" means an issuer that distributes securities of a reporting issuer held by it in accordance with the terms of an exchangeable security of its own issue;

"financial assets" means cash, securities, or any contract of insurance or deposit or evidence thereof that is not a security for the purposes of the Act;

"government incentive security" means

(a) a security, or unit or interest in a partnership that invests in a security, that is issued by a company and for which the company has agreed to renounce in favour of the holder of the security, unit or interest, amounts that will constitute Canadian exploration expense, as defined in subsection 66.1(6) of the ITA, or Canadian development expense, as defined in subsection 66.2(5) of the ITA, or Canadian oil and gas property expense, as defined in subsection 66.4(5) of the ITA; or

(b) a unit or interest in a partnership or joint venture that is issued in order to fund Canadian exploration expense as defined in subsection 66.1(6) of the ITA or Canadian development expense as defined in subsection 66.2(5) of the ITA or Canadian oil and gas property expense as defined in subsection 66.4(5) of the ITA;

"managed account" means an investment portfolio account of a client established in writing with a portfolio adviser who makes investment decisions for the account and has full discretion to trade in securities of the account without requiring the client's express consent to a transaction;

"multiple convertible security" means a security of an issuer that is convertible into or exchangeable for, or carries the right of the holder to purchase, or of the issuer or exchange issuer to cause the purchase of, a convertible security, an exchangeable security or another multiple convertible security;

"MI 45-102" means Multilateral Instrument 45-102 *Resale of Securities*;

"portfolio adviser" means

(a) a portfolio manager; or

(b) a broker or investment dealer exempted from registration as an adviser under subsection 148(1) of the Regulation if that broker or investment dealer is not exempt from the by-laws or regulations of The Toronto Stock Exchange or the Investment Dealers' Association of Canada referred to in that subsection;

"Previous Rule" means Rule 45-501 *Exempt Distributions* as it read when it was published on January 8, 1999 at (1999) 22 OSCB 56;

"related liabilities" means liabilities incurred or assumed for the purpose of financing the acquisition or ownership of financial assets and liabilities that are secured by financial assets;

"spouse", in relation to an individual, means another individual to whom that individual is married, or another individual of the opposite sex or the same sex with whom that individual is living in a conjugal relationship outside marriage;

"Type 1 trade" means a trade in a security under an exemption from the prospectus requirement in clause 72(1)(a), (b), (c), (d), (l), (m), (p) or (q) of the Act, or section 2.3, 2.12, 2.13 or 2.14 of this Rule, or section 2.4, 2.5 or 2.11 of the Previous Rule;

"Type 2 trade" means a trade in a security under an exemption from the prospectus requirement in clause 72(1)(f) (other than a trade to an associated consultant or investor consultant as defined in Rule 45-503 *Trades to Employees, Executives and Consultants*), (h),(i),(j),(k) or (n) of the Act, or section 2.5 or 2.8 of this Rule; and

"underlying security" means a security issued or transferred, or to be issued or transferred, in accordance with the terms of a convertible security, an exchangeable security or a multiple convertible security.

1.2 Interpretation

(1) In this Rule a person or company is considered to be an affiliated entity of another person or company if one is a subsidiary entity of the other, or if both are subsidiary entities of the

same person or company, or if each of them is controlled by the same person or company.

(2) In this Rule a person or company is considered to be controlled by a person or company if

(a) in the case of a person or company,

(i) voting securities of the first-mentioned person or company carrying more than 50 percent of the votes for the election of directors are held, otherwise than by way of security only, by or for the benefit of the other person or company, and

(ii) the votes carried by the securities are entitled, if exercised, to elect a majority of the directors of the first-mentioned person or company;

(b) in the case of a partnership that does not have directors, other than a limited partnership, the second-mentioned person or company holds more than 50 percent of the interests in the partnership; or

(c) in the case of a limited partnership, the general partner is the second-mentioned person or company.

(3) In this Rule a person or company is considered to be a subsidiary entity of another person or company if

(a) it is controlled by,

(i) that other, or

(ii) that other and one or more persons or companies each of which is controlled by that other, or

(iii) two or more persons or companies, each of which is controlled by that other; or

(b) it is a subsidiary entity of a person or company that is the other's subsidiary entity.

PART 2 EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS OF THE ACT

2.1 Exemption for a Trade in a Security of a Closely-held Issuer

(1) Sections 25 and 53 of the Act do not apply to a trade in a security of a closely-held issuer if

(a) following the trade, the issuer will be a closely-held issuer and the aggregate proceeds received by the issuer, and any other issuer engaged in common enterprise with the issuer, in connection with trades made in reliance upon this exemption will not exceed $3,000,000;

(b) no promoter of the issuer has acted as a promoter of any other issuer that has issued a security in reliance upon this exemption within the twelve months preceding the trade; and

(c) no selling or promotional expenses are paid or incurred in connection with the trade, except for services performed by a dealer registered under the Act.

(2) If a trade is made under subsection 2.1(1), the seller shall provide an information statement substantially similar to Form 45-501F3 to the purchaser of the security at least four days prior to the date of the trade unless, following the trade, the issuer will have not more than five beneficial holders of its securities.

2.2 Exemption for a Trade in a Variable Insurance Contract

(1) Sections 25 and 53 of the Act do not apply to a trade by a company licensed under the *Insurance Act* in a variable insurance contract that is

(a) a contract of group insurance;

(b) a whole life insurance contract providing for the payment at maturity of an amount not less than three quarters of the premiums paid up to age 75 for a benefit payable at maturity;

(c) an arrangement for the investment of policy dividends and policy proceeds in a separate and distinct fund to which contributions are made only from policy dividends and policy proceeds; or

(d) a variable life annuity.

(2) For the purposes of subsection (1), "contract", "group insurance", "life insurance" and "policy" have the respective meanings ascribed to them by sections 1 and 171 of the *Insurance Act*.

2.3 Exemption for a Trade to an Accredited Investor - Sections 25 and 53 of the Act do not apply to a trade in a security if the purchaser is an accredited investor and purchases as principal.

2.4 Exemption for a Trade by a Control Person in a Security Acquired under a Formal Take-Over Bid

(1) Section 53 of the Act does not apply to a trade that is a control person distribution in a security that was acquired under a formal bid as defined in Part XX of the Act, if

(a) the offeree issuer had been a reporting issuer for at least 12 months at the date of the bid;

(b) subject to subsection (2), the intention to make the trade was disclosed in the take-over bid circular for the take-over bid;

(c) the trade is made within the period commencing on the date of the expiry of the bid and ending 20 days after that date;

(d) a notice of intention and a declaration prepared in accordance with Form 45-102F3 are filed by the seller before the trade;

(e) an insider report prepared in accordance with Form 55-102F2 is filed by the seller within three days after the completion of the trade; and

(f) no unusual effort is made to prepare the market or to create a demand for the securities and no extraordinary commission is paid for the trade.

(2) Paragraph (1)(b) does not apply to a trade to another person or company that has made a competing formal bid for securities of the same issuer for a per security price not greater than the per security consideration offered by that other person or company in its take-over bid.

2.5 Exemption for a Trade in Connection with a Securities Exchange Issuer Bid - Sections 25 and 53 of the Act do not apply to a trade in a security that is exchanged by or for the account of the offeror with a securityholder of the offeror in connection with an issuer bid as defined in Part XX of the Act if, at the time of the trade, the issuer whose securities are being issued or transferred is a reporting issuer not in default under the Act or the regulations.

2.6 Exemption for a Trade upon Exercise of Conversion Rights in a Convertible Security - Sections 25 and 53 of the Act do not apply to a trade by an issuer in an underlying security of its own issue to a holder of a convertible security or multiple convertible security of the issuer on the exercise by the issuer of its right under the convertible security or multiple convertible security to cause the holder to convert into or purchase the underlying security or on the automatic conversion of the convertible security or multiple convertible security, if no commission or other remuneration is paid or given to others for the trade except for administrative or professional services or for services performed by a registered dealer.

2.7 Exemption for a Trade upon Exercise of Exchange Rights in an Exchangeable Security - Sections 25 and 53 of the Act do not apply to a trade by an exchange issuer in an underlying security to a holder of an exchangeable security or multiple convertible security of the exchange issuer on the exercise by the exchange issuer of its right under the exchangeable security or multiple convertible security to cause the holder to exchange for or purchase the underlying security or on the automatic exchange of the exchangeable security or multiple convertible security, if the exchange issuer delivers to the Commission a written notice stating the date, amount, nature and conditions of the proposed trade, including the net proceeds to be derived by the exchange issuer if the underlying securities are fully taken up and either

(a) the Commission has not informed the exchange issuer in writing within 10 days after the delivery of the notice that it objects to the proposed trade, or

(b) the exchange issuer has delivered to the Commission information relating to the underlying security that is satisfactory to and accepted by the Commission.

2.8 Exemption for a Trade on an Amalgamation, Arrangement or Specified Statutory Procedure - Sections 25 and 53 of the Act do not apply to a trade in a security of an issuer in connection with

(a) a statutory amalgamation or statutory arrangement; or

(b) a statutory procedure under which one issuer takes title to the assets of another issuer that in turn loses its existence by operation of law or under which one issuer merges with one or more issuers, whether or not the securities are issued by the merged issuer.

2.9 Exemption for a Trade in a Security under the *Execution Act* - Sections 25 and 53 of the Act do not apply to a trade in a security by a sheriff under the *Execution Act*, if

(a) there is no published market as defined in Part XX of the Act in respect of the security;

(b) the aggregate acquisition cost to the purchaser is not more than $25,000; and

(c) each written notice to the public soliciting offers for the security or giving notice of the intended auction of the security is accompanied by a statement substantially as follows:

These securities are speculative. No representations are made concerning the securities, or the issuer of the securities. No prospectus is available and the protections, rights and remedies arising out of the prospectus provisions of the *Securities Act*, including statutory rights of rescission and damages, will not be available to the purchaser of these securities.

2.10 Exemption for a Trade in Debt of Conseil Scolaire de L'île de Montréal - Sections 25 and 53 of the Act do not apply to a trade if the security being traded is a bond, debenture or other evidence of indebtedness of the Conseil Scolaire de L'île de Montréal.

2.11 Exemption for a Trade to a Registered Retirement Savings Plan or a Registered Retirement Income Fund - Sections 25 and 53 of the Act do not apply to a trade in a security by an individual or an associate of an individual to a RRSP or a RRIF established by or for that individual or under which that individual is a beneficiary.

2.12 Exemption for Certain Trades in a Security of a Mutual Fund or Non-Redeemable Investment Fund - Sections 25 and 53 of the Act do not apply to a trade in a security of a mutual fund or non-redeemable investment fund that is not a reporting issuer if

(a) the purchaser purchases as principal;

(b) either (i) the security has an aggregate acquisition cost to the purchaser of not less than $150,000 or (ii) the security is issued by a mutual fund or non-redeemable investment fund in which the purchaser then owns securities having either an aggregate acquisition cost or an aggregate net asset value of not less than $150,000; and

(c) the mutual fund or non-redeemable investment fund is managed by a portfolio adviser or a trust corporation registered under the *Loan and Trust Corporations Act*.

2.13 Exemption for a Trade by a Promoter or Issuer in a Government Incentive Security - Sections 25 and 53 of the Act do not apply to a trade by an issuer or by a promoter of an issuer in a security of the issuer that is a government incentive security, if

(a) in the aggregate in all jurisdictions, not more than 75 prospective purchasers are solicited resulting in sales to not more than 50 purchasers;

(b) before entering into an agreement of purchase and sale, the prospective purchaser has been supplied with an offering memorandum that includes information

(i) identifying every officer and director of the issuer,

(ii) identifying every promoter of the issuer,

(iii) giving the particulars of the professional qualifications and associations during the five years before the date of the offering memorandum of each officer, director and promoter of the issuer that are relevant to the offering,

(iv) indicating each of the directors that will be devoting his or her full time to the affairs of the issuer, and

(v) describing the right of action referred to in section 130.1 of the Act that is applicable in respect of the offering memorandum;

(c) the prospective purchaser has access to substantially the same information concerning the issuer that a prospectus filed under the Act would provide and

(i) because of net worth and investment experience or because of consultation with or advice from a person or company that is not a promoter of the issuer and that is an adviser or dealer registered under the Act, is able to evaluate the prospective investment on the basis of information about the investment presented to the prospective purchaser by the issuer or selling securityholder, or

(ii) is a senior officer or director of the issuer or of an affiliated entity of the issuer or a spouse or child of any director or senior officer of the issuer or of an affiliated entity of the issuer,

(d) the offer and sale of the security is not accompanied by an advertisement and no selling or promotional expenses have been paid or incurred for the offer and sale, except for professional services or for services performed by a dealer registered under the Act;

(e) the promoter, if any, has not acted as a promoter of any other issue of securities under this exemption within the calendar year; and

(f) section 3.5 does not make the exemption unavailable.

2.14 Exemption for a Trade in a Security Distributed under Section 2.13 - Sections 25 and 53 of the Act do not apply to a trade in a security that was previously distributed under the exemption in section 2.13, if each of the parties to the trade is one of the not more than 50 purchasers.

PART 3 REMOVAL OF CERTAIN EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS

3.1 Removal of Certain Exemptions Generally - The exemptions from the registration requirement in paragraphs 3, 4, 5, 18 and 21 of subsection 35(1) and paragraph 10 of subsection 35(2) of the Act and the exemptions from the prospectus requirement in clauses (a), (c), (d), (l) and (p) of subsection 72(1) and clause (a) of subsection 73(1) as it relates to paragraph 10 of subsection 35(2) of the Act are not available for a trade in a security.

3.2 Removal of Exemptions for Bonds, Debentures and Other Evidences of Indebtedness - The exemption from the registration requirement in subparagraph 1(c) of subsection 35(2) and the corresponding exemption from the prospectus requirement referred to in clause 73(1)(a) of the Act are not available for a trade in a bond, debenture or other evidence of indebtedness that is subordinate in right of payment to deposits held by the issuer or guarantor of the bond, debenture or other evidence of indebtedness.

3.3 Removal of Exemptions for Securities of a Private Mutual Fund with a Promoter or Manager - The exemption from the registration requirement in paragraph 3 of subsection 35(2) and the corresponding exemption from the prospectus requirement referred to in clause 73(1)(a) of the Act are not available for trades in a security of a private mutual fund if it is administered by a trust company and there is a promoter or manager of the mutual fund other than the trust company.

3.4 Removal of Registration Exemptions for Market Intermediaries

(1) The exemptions from the registration requirement in sections 2.1, 2,2, 2.3, 2.5, 2.6, 2.7, 2.8, 2.9, 2.12, 2.13 and 2.14 are not available to a market intermediary.

(2) A limited market dealer may act as a market intermediary in respect of a trade under an exemption from the registration requirement referred to in subsection (1).

3.5 Determination of Number of Purchasers Under Government Incentive Security Exemption if Purchaser is a Primary Purpose Entity - The exemption in section 2.13 is not available if an entity has been created or is being used primarily to permit the purchase of securities without a prospectus, and the number of members or partners of the partnership, syndicate or unincorporated organization, the number of beneficiaries of the trust, or shareholders of the company, as the case may be, exceeds the number of purchasers referred to in the clause or section.

PART 4 OFFERING MEMORANDUM

4.1 Application of Statutory Right of Action - The right of action referred to in section 130.1 of the Act shall apply in respect of an offering memorandum delivered to a prospective purchaser in connection with a trade made in reliance upon an exemption from the prospectus requirement in section 2.1, 2.3, 2.12 or 2.13.

4.2 Description of Statutory Right of Action in Offering Memorandum – If the seller delivers an offering memorandum to a prospective purchaser in connection with a trade made in reliance upon an exemption from the prospectus requirement in section 2.1, 2.3, 2.12 or 2.13, the right of action referred to in section 130.1 of the Act shall be described in the offering memorandum.

4.3 Delivery of Offering Memorandum to Commission - If an offering memorandum is provided to a purchaser of securities in respect of a trade made in reliance upon an exemption from the prospectus requirement in section 2.1, 2.3, 2.12 or 2.13, the seller shall deliver to the Commission a copy of the offering memorandum within 10 days of the date of the trade.

PART 5 DEALER REGISTRATION

5.1 Removal of Exemption unless Dealer Registered for Trade Described in the Exemption - An exemption from the registration requirement or from the prospectus requirement in the Act or the regulations that refers to a registered dealer is not available for a trade in a security unless the dealer is registered in a category that permits it to act as a dealer for the trade described in the exempting provision.

PART 6 RESTRICTIONS ON RESALE OF SECURITIES DISTRIBUTED UNDER CERTAIN EXEMPTIONS

6.1 Resale of a Security Distributed to a Promoter Under Certain Exemptions – If a security of an issuer is distributed to a promoter of the issuer under an exemption from the prospectus requirement in section 2.1, 2.3, 2.12, 2.13 or 2.14, the first trade in that security by that promoter is a distribution unless the conditions in subsection (2) or (3) of section 2.8 of MI 45-102 are satisfied.

6.2 Resale of a Security Distributed under Section 2.1 - If a security is distributed under the exemption from the prospectus requirement in section 2.1, the first trade in that security, other than a trade referred to in section 6.1, is subject to section 2.6 of MI 45-102.

6.3 Resale of a Security Distributed under Section 2.3, 2.12, 2.13 or 2.14 - If a security is distributed under an exemption from the prospectus requirement in section 2.3, 2.12, or 2.13 or distributed under the exemption from the prospectus requirement in section 2.14, the first trade in that security, other than a trade referred to in section 6.1, is subject to section 2.5 of MI 45-102.

6.4 Resale of a Security Distributed under Clause 72(1)(h) of the Act - If a security is distributed under the exemption from the prospectus requirement in clause 72(1)(h) of the Act, the first trade in that security, other than a trade to which section 6.5 applies, is subject to section 2.6 of MI 45-102.

6.5 Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or

Exchangeable Security Distributed under Certain Exemptions - If an underlying security is distributed under an exemption from the prospectus requirement on conversion or exchange of a multiple convertible security, convertible security or exchangeable security acquired in a Type 1 trade, the first trade in that underlying security is subject to section 2.5 of MI 45-102.

6.6 Resale of a Security Distributed under Section 2.6 or 2.7 - If an underlying security is distributed under an exemption from the prospectus requirement in section 2.6 or 2.7 on a forced conversion or exchange of a multiple convertible security, convertible security or exchangeable security acquired by the holder in a Type 2 trade, the first trade in that underlying security is subject to section 2.6 of MI 45-102.

6.7 Resale of a Security Distributed under Section 2.5 or 2.8 - If a security is distributed under an exemption from the prospectus requirement in section 2.5 or 2.8, the first trade in that security is subject to section 2.6 of MI 45-102.

6.8 Resale of Security Acquired under Certain Exemptions in Rule 45-503 – A trade of an underlying security distributed under an exemption from the prospectus requirement in section 2.2, 3.1, 3.2, 3.3, 5.1 or 8.1 of Rule 45-503 *Trades to Employees, Executives and Consultants*, other than a trade by an associated consultant or investor consultant as defined in Rule 45-503 *Trades to Employees, Executives and Consultants*, is subject to section 2.6 of MI 45-102.

6.9 Resale of a Security Distributed under Section 2.11 – If a security is distributed under the exemption from the prospectus requirement in section 2.11, the first trade in that security is subject to section 2.5 or 2.6 of MI 45-102, whichever section was applicable to the person or company making the initial exempt trade.

PART 7 FILING REQUIREMENTS AND FEES

7.1 Form 45-501F1 - Every report that is required to be filed under subsection 72(3) of the Act or subsection 7.5(1) shall be filed in duplicate and prepared in accordance with Form 45-501F1.

7.2 Form 45-501F2 - Every report that is required to be filed under subsection 7.5(2) shall be filed in duplicate and prepared in accordance with Form 45-501F2.

7.3 Fees for Form 45-501F1

(1) A report filed in Form 45-501F1 shall be accompanied by a fee equal to the greater of

(a) $100; and

(b) subject to subsection (2), the amount calculated using the formula,

A + B

where

"A" is 0.02 percent of the aggregate gross proceeds realized in Ontario from the distribution of securities, other than special warrants, for which the report filed in Form 45-501F1 is filed, and

"B" is 0.04 percent of the aggregate gross proceeds realized in Ontario from the distribution of special warrants for which the report filed in Form 45-501F1 is filed.

(2) The amount calculated under subsection (1) is considered to be $100 if the report filed in Form 45-501F1 is filed for,

(a) a trade in securities if there is no change in beneficial ownership of the securities as a result of the trade;

(b) a subsequent trade in securities acquired under an exemption from the prospectus requirement in clause 72(1)(b) or (q) of the Act or section 2.3; or

(c) a subsequent trade in securities acquired prior to ●, 2001 under an exemption from the prospectus requirement in clause 72(1)(a), (c), (d), (l) or (p) of the Act or section 2.4, 2.5 or 2.11 of the Previous Rule.

7.4 Fees for Form 45-501F2 - A report filed in Form 45-501F2 shall be accompanied by a fee of $100.

7.5 Exempt Trade Reports

(1) Subject to subsections (7) and (8), if a trade is made in reliance upon the exemption from the prospectus requirement in section 2.3, 2.13 or 2.14, other than

(a) a trade to a person or company referred to in paragraphs (p) through (s) of the definition of "accredited investor" in section 1.1, or

(b) a trade to an entity referred to in paragraph (aa) if all of the owners of interests referred to in that paragraph are persons or companies referred to in paragraphs (p) through (s) of the definition of "accredited investor" in section 1.1,

the seller shall, within 10 days of the trade, file a report in accordance with section 7.1.

(2) If a trade is made in reliance upon the conditions in subsection (2) or (3) of section 2.5 of MI 45-102 being satisfied, the seller shall, within 10 days of the trade, file a report in accordance with section 7.2.

(3) If a trade is made in reliance upon the conditions in subsection (2) or (3) of section 2.8 of MI 45-102 being satisfied, the seller shall comply with the requirements of subsections (4) to (7) of that section.

(4) If a trade is made under section 2.6, the issuer shall file the notice and pay the fees prescribed by section 20 of Schedule 1 to the Regulation as if the underlying security had been acquired in a distribution exempt from section 53 of the Act by subclause 72(1)(f)(iii) of the Act.

(5) If a trade is made under section 2.7, the exchange issuer shall pay the fees prescribed by section 21 of Schedule 1 to the Regulation as if the security had been acquired in a distribution exempt from section 53 of the Act by clause 72(1)(h) of the Act.

(6) If a trade is made under section 2.8, the issuer shall pay the fees prescribed by section 23 of Schedule 1 to the Regulation as if section 23 referred to section 2.8 instead of clause 72(1)(i) of the Act.

(7) A report is not required under subsection (1) where, by a trade under section 2.3, a bank, loan corporation or trust corporation acquires from a customer an evidence of indebtedness of the customer or an equity investment in the customer acquired concurrently with an evidence of indebtedness.

(8) Despite subsection (1), a report in respect of a trade in a security of a mutual fund or non-redeemable investment fund made in reliance upon the exemption from the prospectus requirement in section 2.3 may be filed not later than 30 days after the financial year end of the mutual fund or non-redeemable investment fund.

7.6 **Fees for Accredited Investor Application** - An application for recognition, or for renewal of recognition, as an accredited investor shall be accompanied by a fee of $500.

7.7 **Report of a Trade Made under Section 2.12** - If a trade is made in reliance upon the exemption from the prospectus requirement in section 2.12, the issuer shall, not later than thirty days after the financial year end of the issuer in which the trade occurred, file a report, in duplicate, prepared in accordance with Form 45-501F1 and the report shall be accompanied by a fee calculated in accordance with section 7.3.

PART 8 TRANSITIONAL PROVISIONS

8.1 **Accredited Investor Definition Includes Exempt Purchaser** - The definition of "accredited investor" in section 1.1 includes, prior to ● , 2002, a person or company that is recognized by the Commission as an exempt purchaser.

8.2 **Resale of a Security Distributed under Section 2.4, 2.5 or 2.11 of the Previous Rule -** If a security was distributed under an exemption from the prospectus requirement in section 2.4, 2.5 or 2.11 of the Previous Rule, the first trade in that security is subject to section 2.5 of MI 45-102.

8.3 **Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or Exchangeable Security Distributed under Certain Exemptions in the Previous Rule** – If an underlying security was distributed on conversion or exchange of a multiple convertible security, convertible security or exchangeable security acquired in a distribution under an exemption from the prospectus requirement in section 2.4, 2.5 or 2.11 of the Previous Rule, the first trade in that underlying security is subject to Section 2.5 of MI 45-102.

8.4 **Resale of a Security Distributed to a Promoter under Section 2.3 or 2.15 of the Previous Rule -** If a security was distributed to a promoter under an exemption from the prospectus requirement in section 2.3 or 2.15 of the Previous Rule, the first trade in that security is a distribution unless the conditions in subsection (2) or (3) of section 2.8 of MI 45-102 are satisfied.

8.5 **Resale of a Security Distributed under Section 2.9 or 2.10 of the Previous Rule –** If an underlying security was distributed under an exemption from the prospectus requirement in section 2.9 or 2.10 of the Previous Rule on a forced conversion or exchange of a multiple convertible security, convertible security or exchangeable security acquired by the holder in a Type 2 trade, the first trade in that underlying security is subject to section 2.6 of MI 45-102.

8.6 **Resale of a Security Distributed under Section 2.7, 2.8 or 2.17 or Subsection 2.18(1) of the Previous Rule** – If a security was distributed under an exemption from the prospectus requirement in section 2.7, 2.8 or 2.17 of the Previous Rule, or in subsection 2.18(1) of the Previous Rule after the issuer had ceased to be a private issuer for purposes of the *Securities Act* (British Columbia), the first trade in that security is subject to section 2.6 of MI 45-102.

PART 9 EFFECTIVE DATE

9.1 **Effective Date** – This instrument shall come into force on ●, 2001.

COMPANION POLICY 45-501CP TO
ONTARIO SECURITIES COMMISSION RULE 45-501
EXEMPT DISTRIBUTIONS

PART 1 PURPOSE AND DEFINITIONS

1.1 **Purpose** - This policy statement sets forth the views of the Commission as to the manner in which certain provisions of the Act and the rules relating to the exemptions from the prospectus and registration requirements are to be interpreted and applied.

1.2 **Definitions** - In this Policy, "private placement exemptions" means the prospectus and registration exemptions available for

(a) sales of securities of closely-held issuers under section 2.1 of Rule 45-501; and

(b) sales of securities to accredited investors under section 2.3 of Rule 45-501.

PART 2 EXEMPTIONS FROM THE REGISTRATION AND PROSPECTUS REQUIREMENTS OF THE ACT

2.1 **Interaction of Private Placement Exemptions** - The Commission recognizes that a seller of securities may, in connection with any distribution of securities, rely concurrently on more than one private placement exemption. The Commission notes that where the seller is paying or incurring selling or promotional expenses in connection with the distribution, other than for the services of a dealer registered under the Act, the seller may not be able to rely on the exemption in section 2.1. The Commission takes the view that expenses incurred in connection with the preparation and delivery of an offering memorandum do not constitute selling or promotional expenses in this context.

2.2 **Accredited Investor Status For Individuals**

(1) Paragraph (m) of the "accredited investor" definition in section 1.1 of Rule 45-501 refers to individuals who, alone or together with a spouse, beneficially own financial assets having an aggregate net realizable value that, before taxes but net of any related liabilities, exceeds $1,000,000. As a general matter, it should not be difficult to determine whether financial assets are beneficially owned by an individual (or an individual's spouse) in any particular instance. However, financial assets held in a trust or in other types of investment vehicles for the benefit of an individual may raise questions as to whether the individual beneficially owns the financial assets in the circumstances. The Commission is of the view that the following factors are indicative of beneficial ownership of financial assets:

(a) physical or a constructive possession of evidence of ownership of the financial asset;

(b) entitlement to receipt of any income generated by the financial asset;

(c) risk of loss of the value of the financial asset; and

(d) the ability to dispose of the financial asset or otherwise deal with it as the individual sees fit.

By way of example, securities held in a self-directed RRSP for the sole benefit of an individual would be beneficially owned by that individual. In general, financial assets in a spousal RRSP would also be included for purposes of the threshold test because paragraph (m) takes into account financial assets owned beneficially by a spouse. However, financial assets held in a group RRSP under which the individual would not have the ability to acquire the financial assets and deal with them directly would not meet this beneficial ownership requirement.

(2) The Commission notes that paragraphs (m) and (n) of the "accredited investor" definition are designed to treat spouses as an investing unit such that either spouse may qualify as an accredited investor if both spouses, taken together, beneficially own the requisite amount of financial assets or earn the requisite net income. As well, the financial asset test and the net income test prescribed in paragraphs (m) and (n), respectively, are to be applied only at the time of the trade such that there is no obligation on the seller to monitor the purchaser's continuing qualification as an accredited investor after the completion of the trade.

(3) Paragraph (q) of the "accredited investor" definition refers to certain family members of an officer or director of the issuer. The Commission notes that officers and directors of an issuer or its affiliated entities are, in effect, treated as accredited investors under Rule 45-503 *Trades to Employees, Executives and Consultants*.

2.3 **Closely-Held Issuer Exemption**

(1) The exemption in section 2.1 relating to securities of closely-held issuers is available to the closely-held issuer itself in respect of an issue of its own securities and to any holder of the issuer's securities in respect of a sale of the securities. A closely-held issuer may issue its own securities in reliance upon the exemption in section 2.1 so long as it is able to meet the criteria for the availability of the exemption in that section. In particular, a closely-held issuer may no longer use the closely-held issuer exemption

once it has received aggregate proceeds of $3,000,000 from trades made in reliance upon the exemption. However, a holder of securities of a closely-held issuer may rely upon the exemption in section 2.1 in connection with any resale of the securities so long as the issuer continues to be a closely-held issuer after the resale. The issuer does not cease to be a closely-held issuer solely because it has raised $3,000,000 in aggregate proceeds using the exemption.

(2) The Commission notes that a closely-held issuer will be in a position to facilitate the use of the exemption in section 2.1 for the resale of its securities by limiting the number of its security holders using the share transfer restrictions in its constating documents or in an agreement with its security holders. Once the issuer no longer meets the closely-held issuer definition, a resale of securities acquired under the exemption in section 2.1 may only be made in reliance upon another exemption or by complying with the relevant provisions of Multilateral Instrument 45-102 *Resale of Securities* ("MI 45-102").

(3) The Commission notes that the restriction on the use of the exemption in section 2.1, which refers to aggregate proceeds of $3,000,000, is based on the aggregate of all proceeds received by the issuer at any time from trades made in reliance upon the exemption in section 2.1. Proceeds received by the issuer from trades made in reliance upon other exemptions, including exemptions available prior to the date when the exemption in section 2.1 first became available, are not relevant. In particular, the proceeds realized by the issuer from trades to accredited investors need not be included in determining whether the $3,000,000 threshold would be exceeded in respect of any proposed trade under section 2.1. However, if the issuer has not filed a report on Form 45-501F1 in respect of a trade with an accredited investor where such a filing is required, it will be presumed that the trade was made in reliance upon section 2.1, in which case the proceeds of that trade must be counted for purposes of the aggregate proceeds limit.

(4) The Commission notes that the term "common enterprise" is intended to operate as an anti-avoidance mechanism to the extent that multiple business entities are organized for the purposes of financing what is essentially a single business enterprise in order to benefit from continued or excessive use of the closely-held issuer exemption. The Commission takes the view that commonality of ownership combined with commonality of business plans will be particularly indicative of a "common enterprise".

2.4 **Sunset of Pooled Fund Rulings** – Prior to the implementation of Rule 45-501 on ●, 2001, the Commission has granted numerous rulings under subsection 74(1) of the Act providing exemptive relief from the prospectus and registration requirements to pooled fund issuers in respect of, among other things, the sale of additional pooled fund interests to investors that previously purchased pooled fund interests under an exemption. In general, these rulings contained a "sunset" provision stating that the ruling would terminate following the adoption of a rule regarding trades in securities of pooled funds. Rule 45-501 contains a "transitional" exemption in section 2.12 that exempts the sale of securities of a private pooled fund to an investor acquiring at least $150,000 of such securities as well as the sale of additional securities of the same fund to such an investor. The Commission considers that this transitional pooled fund exemption, together with the accredited investor exemption in section 2.3 of Rule 45-501 which exempts sales of securities to certain types of accredited investors, provide adequate transitional relief from the prospectus and registration requirements for trades in pooled fund interests to investors. OSC Rule 81-501 *Mutual Fund Reinvestment Plans* also continues to apply to securities of pooled funds that are issued to investors under reinvestment plans whereby distributions of income, capital or capital gains to investors are reinvested in additional securities of that pooled fund. Accordingly, the Commission takes the view that the rulings described above expire upon implementation of Rule 45-501. The Commission considers that section 2.12 is a "transitional" exemption that maintains the status quo for pooled funds until such time as the Commission determines the appropriate regulatory regime for pooled funds.

2.5 **Trades on an Amalgamation, Arrangement or Specified Statutory Procedure** - Clause 72(1)(i) of the Act and section 2.8 of Rule 45-501 provide exemptions for trades in securities in connection with a statutory amalgamation or arrangement or other statutory procedure. The Commission is of the view that the references to statute in these provisions refer to any statute of a jurisdiction or foreign jurisdiction under which the entities involved have been incorporated or created and exist and under which the transaction is taking place.

2.6 **Three-Cornered Amalgamations** - Certain corporate statutes permit a so-called "three-cornered merger or amalgamation" under which two companies will amalgamate or merge and security holders of the amalgamating or merging entities will receive securities of a third party affiliate of one amalgamating or merging entity. Section 2.8 of Rule 45-501 exempts these trades as the exemption applies to any trade made in connection with an amalgamation or merger.

2.7 **Other Exemptions** - There are various other exemptions from the prospectus and registration requirements that are available to sellers of securities in prescribed circumstances, including Rule 45-503 *Trades to Employees, Executives and Consultants* which exempts sales of securities of an issuer to its employees and executives, among others. The

Commission notes, in particular, that certain exemptions previously contained in Rule 45-501 as it read when it was originally adopted are now contained in MI 45-102. Market participants engaged in the purchase and sale of securities under exemptions from the prospectus and registration requirements should read MI 45-102 together with Rule 45-501 to ensure that they have duly considered all regulatory requirements applicable to exempt distributions of securities in Ontario.

2.8 Applications for Accredited Investor Recognition - Paragraph (u) of the "accredited investor" definition in section 1.1 of Rule 45-501 contemplates that a person or company may apply to be recognized by the Commission as an accredited investor. The Commission will consider applications for accredited investor recognition submitted by or on behalf of investors that do not meet any of the other criteria for accredited investor status but nevertheless have the requisite sophistication or financial resources. The Commission has not adopted any specific criteria for granting accredited investor recognition to applicants as the Commission believes that the "accredited investor" definition generally covers all of the types of investors that do not require the protection of the prospectus and registration requirements under the Act. If the Commission considers it appropriate in the circumstances, it may grant accredited investor recognition to an investor on terms and conditions, including a requirement that the investor apply annually for renewal of accredited investor recognition. The Commission notes that section 8.1 of Rule 45-501 provides, as a transitional matter, that a person or company previously recognized by the Commission as an exempt purchaser will be considered an accredited investor for a period of one year from the effective date of Rule 45-501. The Commission believes that a person or company previously recognized as an exempt purchaser should have little difficulty qualifying as an accredited investor under Rule 45-501 unless the person or company has experienced a change in their financial circumstances.

PART 3 CERTIFICATION OF FACTUAL MATTERS

3.1 Seller's Due Diligence - It is the seller's responsibility to ensure that its trades in securities are made in compliance with applicable securities laws. In the case of a seller's reliance upon exemptions from the prospectus and registration requirements, the Commission expects that the seller will exercise reasonable diligence for the purposes of determining the availability of the exemption used in any particular circumstances. The Commission will normally be satisfied that a seller has exercised reasonable diligence in relying upon a particular exemption if the seller has obtained statutory declarations or written certifications from the purchasers, unless the seller has knowledge that any facts set out in the declarations or certifications are incorrect**.** In circumstances where a seller has recently obtained a statutory declaration or a written certification from a purchaser with whom a further trade is being made on an exempt basis, the seller may continue to rely upon the recently obtained statutory declaration or certification unless the seller has reason to believe that the statutory declaration or certification is no longer valid in the circumstances.

PART 4 OFFERING MEMORANDA

4.1 Use of Offering Memoranda in Connection with Private Placements

(1) Part 4 of Rule 45-501 provides for the application of the statutory right of action referred to in section 130.1 of the Act if an offering memorandum is delivered to a prospective investor in connection with a trade made in reliance upon a prospectus exemption in section 2.1, 2.3, 2.12 or 2.13 of Rule 45-501. In this case, the statutory right of action must be described in the offering memorandum and a copy of the offering memorandum must be delivered to the Commission. With the exception of the government incentive security exemption in section 2.13, there is no obligation to prepare an offering memorandum for use in connection with a trade made in reliance upon the above-noted prospectus exemptions. However, business practice may dictate the preparation of offering material that is delivered voluntarily to purchasers in connection with exempt trades under section 2.1, 2.3, or 2.12. This offering material may constitute an "offering memorandum" as defined in Ontario securities law. The statutory right of rescission or damages applies when the offering memorandum is provided mandatorily in connection with an exempt trade made under section 2.13, or voluntarily in connection with exempt trades made under section 2.1, 2.3 or 2.12, including an exempt trade made under section 2.3 to a government or financial institution that is an accredited investor. However, a document delivered in connection with a sale of securities made otherwise than in reliance upon the above-noted exemptions does not give rise to the statutory right of action or subject the seller to the requirements of Part 4.

(2) With the exception of an offering memorandum that is provided in respect of a trade in government incentive securities made under the exemption in section 2.13, Ontario securities law generally does not prescribe what an offering memorandum should contain.

(3) The Commission cautions against the practice of providing preliminary offering material to certain prospective investors before furnishing a "final" offering memorandum unless the material contains a description of the statutory right of action available to purchasers in situations when the statutory right of action applies and a description is required. The only material

prepared in connection with the private placement for delivery to investors, other than a "term sheet" (representing a skeletal outline of the features of an issue without dealing extensively with the business and affairs of the issuer), should consist of an offering memorandum describing the statutory right of action and complying in all other respects with Ontario securities law.

PART 5 RESTRICTIONS ON RESALE OF SECURITIES

5.1 Incorporation of Multilateral Instrument 45-102 *Resale of Securities* - Parts 6 and 8 of the Rule imposes resale restrictions on the first trades in securities distributed under certain exemptions from the prospectus requirements. Different types of resale restrictions are imposed depending upon the nature of the prospectus exemption under which the securities were distributed. In each case, the applicable resale restrictions are incorporated by reference to a specific section of MI 45-102. Sellers of securities are reminded that these resale restrictions need not apply if the seller is able to rely upon another prospectus exemption in the Act or in a Commission rule in respect of the resale of the securities in question.

PART 6 COMMISSION REVIEW

6.1 Review of Offering Material - Although sellers of securities who rely upon the private placement exemptions are required to deliver to the Commission copies of offering material that they use in connection with the exempt trades if the offering material constitutes an "offering memorandum" as defined in Ontario securities law, the offering material is not generally reviewed or commented upon by Commission staff.

6.2 Other Regulatory Approvals - Given the self-policing nature of exempt distributions and the fact that offering memoranda are not routinely reviewed by Commission staff, the decision relating to the appropriate disclosure in an offering memorandum rests with the issuer, the selling securityholder and their advisors. If Commission staff becomes aware of an offering memorandum that fails to disclose material information relating to the securities that are the subject of the transaction, staff may seek to intervene to effect remedial action.

FORM 45-501F1

Securities Act (Ontario)

Report under Section 72(3) of the Act or Section 7.5(1) of Rule 45-501

(To be used for reports of trades made in reliance upon
clause 72(1)(b) or (q) of the Act, or Section 2.3, 2.12, 2.13 or 2.14 of Rule 45-501)

1. **Full name and address of the seller.**

2. **Full name and address of the issuer of the securities traded.**

3. **Description of the securities traded.**

4. **Date of the trade(s).**

5. **Particulars of the trade(s).**

Name of Purchaser and Municipality and Jurisdiction of Residence	Amount or Number of Securities Purchased	Purchaser Price	Total Purchase Price (Canadian $)	Exemption Relied Upon

6. **The seller has prepared and certified a statement containing the full legal name and the full residential address of each purchaser identified in section 5 and a certified true copy of the list will be provided to the Commission upon request.**

7. **State the name and address of any person acting as agent in connection with trade(s) and the compensation paid or to be paid to such agent.**

8. **Calculation of Fees payable upon filing Form 45-501F1: (See section 7.3 of Rule 45-501 Exempt Distributions).**

   Total Fees payable: $

9. **Certificate of seller or agent of seller.**

The undersigned seller hereby certifies, or the undersigned agent of the seller hereby certifies to the best of the agent's information and belief, that the statements made in this report are true and correct.

DATED at

this day of , 20___.

(Name of seller or agent - please print)

(Signature)

(Official capacity - please print)

(Please print name of individual whose signature appears above, if different from name of seller or agent printed above)

Notice + Collection and Use of Personal Information

The personal information prescribed by this form is collected on behalf of and used by the Ontario Securities Commission for purposes of administration and enforcement provisions of the securities legislation in Ontario. All of the information prescribed by this form, except for the information contained in the statement required to be prepared and certified by the seller under section 6 of this form, is made available to the public under the securities legislation of Ontario. If you have any questions about the collection and use of this information, contact the Ontario Securities Commission at the address below:

Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8
Attention: Administrative Assistant to the Director of Corporate Finance
Telephone: (416) 593-8200
Facsimile: (416) 593-8177

Instructions:

1. In answer to section 7 give the name of the person or company who has been or will be paid remuneration directly related to the trade(s), such as commissions, discounts or other fees or payments of a similar nature. It is not necessary to include payments for services incidental to the trade such as clerical, printing, legal or accounting services.

2. If the space provided for any answer is insufficient, additional sheets may be used and must be cross-referred to the relevant item and properly identified and signed by the person whose signature appears on the report.

3. Cheques must be made payable to the Ontario Securities Commission in the amount determined in section 8 above.

4. Please print or type and file two signed copies with:

Ontario Securities Commission
Suite 1900, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8

FORM 45-501F2

Securities Act (Ontario)
Report under section 7.5(2) of Rule 45-501

1. **Full name and address of the seller.**

2. **Full name and address of reporting issuer whose securities were traded.**

3. **Particulars of the trade(s).**

Date of Trade	Type of Security	Amount or Number of Securities Traded	Selling Price

4. **Full name and municipality of residence of the party from whom the seller acquired the securities and the date of acquisition.**

5. **Certificate of seller or agent of seller.**

The undersigned seller hereby certifies, or the undersigned agent of the seller hereby certifies to the best of the agent's information and belief, that:

(1) the information given in this report is true and correct, and

(2) (a) no unusual effort has been made to prepare the market or create a demand for the securities, and

(b) no extraordinary commission or consideration has been or has been agreed to be paid in respect of the trade covered by this report.

Instructions:

1. If the space provided for any answer is insufficient, additional sheets may be used and must be cross-referred to the relevant item and properly identified and signed by the person whose signature appears on the report.

2. Cheques must be made payable to the Ontario Securities Commission in the amount prescribed in section 7.4 of Rule 45-501 Exempt Distributions.

3. Please print or type and file two signed copies with:

Ontario Securities Commission
Suite 1900, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8

DATED at

this day of , 20___.

(Name of seller or agent - please print)

(Signature)

(Official capacity - please print)

(Please print name of individual whose signature appears above, if different from name of seller or agent printed above)

Notice + Collection and Use of Personal Information

The personal information prescribed by this form is collected on behalf of and used by the Ontario Securities Commission for purposes of administration and enforcement provisions of the securities legislation in Ontario. All of the information prescribed by this form, except for the information contained in the statement required to be prepared and certified by the seller, is made available to the public under the securities legislation of Ontario. If you have any questions about the collection and use of this information, contact the Ontario Securities Commission at the address below:

Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8
Attention: Administrative Assistant to the Director of Corporate Finance
Telephone: (416) 593-8200
Facsimile: (416) 593-8177

FORM 45-501F3
FORM OF INFORMATION STATEMENT

Introduction

Ontario securities laws have been relaxed to make it easier for small businesses to raise start-up capital from the public. Many potential investors may view this change in securities laws as an opportunity to "get in on the ground floor" of emerging businesses and to "hit it big" as these small businesses grow into large ones.

Statistically, most small businesses fail within a few years. Small business investments are among the most risky that investors can make. This information statement suggests matters for you to consider in deciding whether to make a small business investment.

Risks and Investment Strategy

A basic principle of investing in a small business is: **NEVER MAKE A SMALL BUSINESS INVESTMENT THAT YOU CANNOT AFFORD TO LOSE IN ITS ENTIRETY**. Never use funds that might be needed for other purposes, such as a post-secondary education, retirement, loan repayment or medical expenses, and never borrow money to make such an investment. Instead use funds that you already have set aside and that otherwise would be used for a consumer purchase, such as a vacation or a stereo system.

Never let anyone convince you that the investment is not risky. Any such assurance is almost always inaccurate. Among other risk factors, small business investments generally are highly illiquid, even if they are not subject to any legal restrictions on their transferability. This lack of liquidity means that, if the company takes a turn for the worse or if you suddenly need the funds you have invested in the company, you may not be able to sell your securities.

Also, it is important to realize that, just because the proposed offering of securities is permitted under Ontario securities law does not mean that the particular investment will be successful. Neither the Ontario Securities Commission nor any other government agency evaluates or endorses the merits of investments. Anyone who suggests that the Ontario Securities Commission has endorsed the merits of the investment is breaking the law.

If you plan to invest a large amount of money in a small business, you should consider investing smaller amounts in several small businesses. A few highly successful investments can offset the unsuccessful ones. Even when using this strategy, **DO NOT INVEST FUNDS YOU CANNOT AFFORD TO LOSE IN THEIR ENTIRETY**.

Analyzing the Investment

Although there is no magic formula for making successful investment decisions, certain factors are often considered particularly important by professional venture investors. Some questions to consider are as follows:

1. How long has the company been in business? If it is a start-up or has only a brief operating history, are you being asked to pay more than the shares are worth?

2. Consider whether management is dealing unfairly with investors or putting itself in a position where it will be unaccountable to investors. For example, is management taking salaries or other benefits that are too large in light of the company's stage of development? Are outside investors putting up 80% of the money but receiving only 10% of the company's shares? Will outside investors have any voting power to elect representatives to the board of directors?

3. How much experience does management have in the industry and in small business? How successful were the managers in previous businesses?

4. Do you know enough about the industry to be able to evaluate the company and make a wise investment?

5. Does the company have a realistic business plan and do they have the resources to market the product or service successfully?

6. How reliable is the financial information, if any, that has been provided to you by the persons promoting investment in the company?

There are many other questions to be answered, but you should be able to answer these before you consider investing. If you have not been provided with the information needed to answer these and any other questions you may have about the proposed investment, make sure that you obtain the information you need from people authorized to speak on the company's behalf (*e.g.*, management or the directors) before you advance any funds or sign any commitment to advance funds to the company.

Making Money on Your Investment

The two classic methods for making money on an investment in a small business are: (1) resale of the securities in the public securities markets following a public offering; and (2) receiving cash or marketable securities in a merger or other acquisition of the company.

If the company is the type that is not likely to go public or be acquired within a reasonable time (*i.e.*, a family-owned or closely-held corporation), it may not be a good investment for you irrespective of its prospects for success because of the lack of opportunity to cash in on the investment. Management of a successful private company may receive a good return indefinitely through salaries and bonuses but it is unlikely that there will be profits sufficient to pay dividends commensurate with the risk of the investment.

Other Suggestions

It is generally a good idea to meet with management of the company face-to-face to size them up. Focus on experience and track record rather than a smooth sales presentation. If at all possible, take a sophisticated business person with you to help in your analysis.

Even the best venture offerings are highly risky. If you have a nagging sense of doubt, there is probably a good reason for it. Good investments are based on sound business criteria and not emotions. If you are not entirely comfortable, the best approach is usually not to invest. There will be many other opportunities. Do not let anyone pressure you into making a premature decision.

Conclusion

Greater numbers of public investors are "getting in on the ground floor" by investing in small businesses. When successful, these enterprises enhance the economy and provide jobs for its citizens. They also provide investment opportunities. However, an opportunity to invest must be considered in light of the inherently risky nature of small business investments.

In considering a small business investment, you should proceed with caution, and above all, never invest more than you can afford to lose.